

Current	Previous
CMP : Rs.95	
Rating : BUY	Rating : HOLD
Target : Rs.115	Target : Rs.85

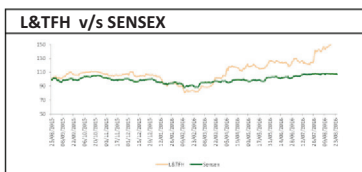
STOCK INFO	
Bse	533519
Nse	L&TFH
Bloomberg	LTFH.IN
Reuters	LTFH.BO
Sector	NBFC
Face Value (Rs)	10
Equity Capital (Rs Mn)	17538
Mkt Cap (Rs Mn)	166,610
52w H/L (Rs)	96/48
Avg Daily Vol (Bse+Nse)	4,146,590

SHAREHOLDING PATTERN		%
(as on Jun. 2016)		
Others, Incl Public		33.3
Promoters		66.7

Source: BSE

STOCK PER. (%)	1m	3m	12m
L&TFH	12%	29%	53%
Sensex	-1%	6%	7%

Source: Capitaline, IndiaNivesh Research



Source: Capitaline, IndiaNivesh Research

L&T Finance Holdings (LTFH) has moved up by 23% in last 3 months due to better than expected Q1FY17 performance, long term strategy of improving ROEs significantly from current 13% and significant valuation discount compared to peers. Recently we had an interaction with management of LTFH to know the developments with regards to implementation of new strategy. Thereafter we have revisited our estimates and assumptions to capture in slightly longer view in our model and its likely impact on valuations. We note that LTFH's management has taken right steps to improve its long term ROEs materially from current 13% which will be led by 1) decline in defocused portfolio where the risk is higher like Infra, CV, CE and long term SME financing 2) significantly improving cost to income by closing the overlapped branches (like closing down a branch where there is a branch of L&T Finance and also of L&T Housing in same location / area), 3) reducing the risk in wholesale / infra business by focusing on only operational projects which is likely to limit provisioning and 4) stable consolidated NIMs. While there is upside risk to our margins assumption mainly due to 1) likely positive surprise from higher growth in Tractor book which is high yielding and 2) increase in Loan Against property and develop financing book which again is high yielding. Hence we upgrade rating to BUY with upwards revised target price of Rs 115, implying 2.8x FY18 ABV (3 years PT of Rs 155 based on 2.8x FY20 ABV). Timely implementation of strategy remains the key risk to our recommendation. (Please note that LTFH has changed its reporting methodology as a part of change in business strategy which is articulated in Q4FY16. Hence various break ups are provided in the form of 1) focused products and de focused products and 2) segmental break up in the form of Rural, Housing and Wholesale (as against Retail and Wholesale earlier).

Investment Rationales:

Loan growth to remain lower in FY17E due to decline in defocused book, likely to improve in FY18E:

LTFH has articulated its new business strategy for FY20 which is to improve ROEs to high teen by focusing on only high margin products. Hence post Q1FY17 we have seen 26% yoy and 11% decline in de-focused portfolio which includes Cars, Leases, MHCV, SCV, LCV, CE and SME Term Loans. We believe strategy of moving away from long term SME financing and CV, CE financing is a move in right direction as it will reduce risk of cyclicity of business. Hence focus on selective products in retail like Micro Financing, Vehicle financing, self employed home loan and Developer financing (selectively) will not only ensure sustainable growth but also better margins. As per management, overall Loan book is likely to grow by 15% in FY17E mainly due to run down of defocused portfolio and higher growth in few products in focused portfolio. However growth is likely to remain higher in FY18E as defocused portfolio will vanish completely.

LTFH's new strategy has started to show its results from Q1FY17 itself as loan book in defocused book has de-grown by 26% yoy and 11% qoq and Focused book grew 23% yoy. We believe this is commendable performance despite large part of LTFH's team was busy in integrating branches, moving their work places and closing their defocused book, they are able to deliver over all loan growth even on qoq basis. Further loan book composition is likely to change gradually by FY20 wherein retail (including housing) and wholesale will have equal proportion as against current 33% in retail, 50% wholesale and remaining defocused portfolio.

Daljeet S. Kohli
Head of Research

Tel: +91 22 66188826
daljeet.kohli@indianivesh.in

Yogesh Hotwani
Research Analyst

Tel: +91 22 66188839
yogesh.hotwani@indianivesh.in

Loan Book (Rs mn)	% of total	Q1FY17	Q1FY16	% YoY	Q4FY16	% QoQ
Microfinance	4.2	24210	12130	99.6	22340	8.4
2W Finance	3.1	17700	14780	19.8	17610	0.5
Farm Equipment	7.6	43940	47960	-8.4	46490	-5.5
Total Rural Finance	14.9	85860	74860	14.7	86440	-0.7
Home Loan / LAP	11.5	66240	41460	59.8	63130	4.9
Real Estate Finance	6.6	37840	26350	43.6	34980	8.2
Housing Finance	18.0	104080	67810	53.5	98110	6.1
Infra Finance	47.7	275570	222150	24.0	271790	1.4
Structured Corp Fin.	8.1	46690	49510	-5.7	49790	-6.2
Supply Chain Fin.	3.7	21100	18230	15.7	22870	-7.7
Wholesale Fin.	59.5	343360	289890	18.4	344450	-0.3
Total Focused Products	92.4	533310	432560	23.3	529000	0.8
De-Focused Products	7.6	44050	59620	-26.1	49310	-10.7
Total	100.0	577360	492180	17.3	578310	-0.2
Disbursements (Rs mn)	% of total	Q1FY17	Q1FY16	% YoY	Q4FY16	% QoQ
Microfinance	1.3	7670	4850	58.1	9540	-19.6
2W Finance	0.6	3600	8190	-56.0	4170	-13.7
Farm Equipment	0.6	3480	3490	-0.3	3810	-8.7
Total Rural Finance	2.6	14750	16530	-10.8	17530	-15.9
Home Loan / LAP	1.1	6520	6810	-4.3	11380	-42.7
Real Estate Finance	0.7	3930	9550	-58.8	4600	-14.6
Housing Finance	1.8	10450	16360	-36.1	15980	-34.6
Infra Finance	3.7	21120	20600	2.5	31890	-33.8
Structured Corp Fin.	0.4	2330	10290	-77.4	5700	-59.1
Supply Chain Fin.	4.9	28120	21640	29.9	30790	-8.7
Wholesale Fin.	8.9	51560	52530	-1.8	68380	-24.6
Total Focused Products	13.3	76770	85420	-10.1	101890	-24.7
De-Focused Products	0.1	350	3020	-88.4	4990	-93.0
Total	13.4	77110	88450	-12.8	106880	-27.9

Source: Company, IndiaNivesh Research

Transition to 90 days likely by FY18, Asset quality will be better thereafter:

Currently LTFH recognize NPAs based on 120 dpd which is inline with regulatory requirement for NBFCs. However despite this, LTFH was successful in improving in asset quality by 27 and 69 bps qoq decline in Consolidated Gross and Net NPAs to 4.6% and 3.1% respectively based on 120 dpd. Asset quality in rural business deteriorated as Gross / Net NPAs increased to 9.6% / 7.43% (vs 8.4% / 7% in Q4FY16) while in wholesale business it improved to 3% / 1.9% (vs 3.6% / 2.8% in Q4FY16). We believe asset quality in rural business is likely to improve from Q2FY17 onwards as monsoon has played out well in most part. Further we believe transition to 90 days will not have significant impact on company as segments which are in focus are doing better for industry as a whole like Home loan, Micro Finance, 2 Wheeler financing and short term financing to operational infrastructure projects. As per management, income reversals based on 90 days will be done in FY17 itself however reporting of Gross / Net NPA based on 90 dpd is likely in FY18.

Asset Quality	Q1FY17	Q1FY16	% YoY	Q4FY16	% QoQ
L&T Finance Hldg (Cons)					
Gross NPA*	25990	26350	-1.4	27558	-5.7
Net NPA*	17512	21177	-17.3	21442	-18.3
Gross NPA (%)*	4.6	5.5	-87	4.9	-27
Net NPA (%)*	3.1	4.4	-130	3.8	-69

Source: Company, IndiaNivesh Research, *120 dpd

Better Margins / lower cost to income will led to ROEs improvement, significant re-rating on cards:

We believe LTFH's margins are likely to remain healthy at 6.2% as we believe part of margin expansion from high yielding segments will be neutralized by financing operational infrastructure projects where the margins are highly competitive. Further as per management's new strategy, there will be significant decline in cost to income from current 37% to 30% over longer term. To achieve this, the company has taken various steps like 1)